



NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 702

[NCUA-2022-0138]

RIN 3133-AF43

Subordinated Debt

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed rule.

SUMMARY: The NCUA Board (Board) is proposing to amend the Subordinated Debt rule (the Current Rule), which the Board finalized in December 2020 with an effective date of January 1, 2022. This proposal would make two changes related to the maturity of Subordinated Debt Notes (Notes) and Grandfathered Secondary Capital (GSC). Specifically, this proposal would replace the maximum maturity of Notes with a requirement that any credit union seeking to issue Notes with maturities longer than 20 years to demonstrate how such instruments would continue to be considered “debt.” This proposed rule would also extend the Regulatory Capital treatment of GSC to the later of 30 years from the date of issuance or January 1, 2052. This proposed extension would align the Regulatory Capital treatment of GSC with the maximum permissible maturity for any secondary capital issued to the United States Government or one of its subdivisions (U.S. Government), under an application approved before January 1, 2022. This

proposed change would benefit eligible low-income credit unions (LICUs) that are either participating in the U.S. Department of the Treasury's (Treasury) Emergency Capital Investment Program (ECIP) or other programs administered by the U.S. Government. This change would also cohere the requirements in the Current Rule related to maturities and Regulatory Capital treatment of Notes and the Regulatory Capital treatment of GSC, while continuing to ensure that credit unions are operating within their statutory authority. The Board is making four other, minor modifications to the Current Rule to make it more user-friendly and flexible. Specifically, the Board is proposing to amend the definition of "Qualified Counsel" to clarify that such person(s) is not required to be licensed to practice law in every jurisdiction that may relate to an issuance. The Board is also proposing to amend two sections of the Current Rule to remove the "statement of cash flow" from the Pro Forma Financial Statements requirement and replace it with a requirement for "cash flow projections." This change would better align the requirements of the Current Rule with the customary way credit unions develop Pro Forma Financial Statements and "cash flow projections." Next, the Board is proposing to revise the section of the Current Rule on filing requirements and inspection of documents. This proposed change would align this section of the Current Rule with current agency procedures. Finally, the Board is proposing to remove a parenthetical reference related to GSC that no longer counts as Regulatory Capital. This change would align the rule with recent changes made to the Call Report.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit written comments, identified by RIN 3133-AF43, by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <https://www.regulations.gov>. Follow the instructions for submitting comments on Docket NCUA-2022-0138.
- Mail: Address to Melane Conyers-Ausbrooks, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery or Courier: Same as mail address.

Public Inspection: You may view all public comments on the Federal eRulemaking Portal at <https://www.regulations.gov>, as submitted, except for those we cannot post for technical reasons. The NCUA will not edit or remove any identifying or contact information from the public comments submitted. Due to social distancing measures in effect, the usual opportunity to inspect paper copies of comments in the NCUA's law library is not currently available. After social distancing measures are relaxed, visitors may make an appointment to review paper copies by calling (703) 518-6540 or e-mailing OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: *Policy:* Tom Fay, Director of Capital Markets, Office of Examination and Insurance. *Legal:* Justin M. Anderson, Senior Staff Attorney, Office of General Counsel, 1775 Duke Street, Alexandria, VA 22314-3428. Tom Fay can be reached at (703) 518-1179, and Justin Anderson can be reached at (703) 518-6540.

SUPPLEMENTARY INFORMATION:

I. Background

A. The current rule history

At its December 2020 meeting, the Board issued a final Subordinated Debt rule (the final rule).¹ The final rule permitted LICUs, complex credit unions, and new credit unions to issue Subordinated Debt for purposes of Regulatory Capital treatment.² Relevant to this proposed rule, the final rule included a provision providing that any secondary capital issued by LICUs under previously effective 12 CFR § 701.34(b), outstanding as of the effective date of the final rule, would be considered GSC. The grandfathering provision of the final rule allowed LICUs with GSC to continue to be subject to the requirements of § 701.34(b), (c), and (d) (recodified in the Current Rule as § 702.414), rather than the requirements of the Current Rule. The final rule also included a provision stating that any issuances of secondary capital not completed by January 1, 2022, are, as of January 1, 2022, subject to the requirements of the Current Rule. Finally, the grandfathering provision in the final rule stated that GSC would continue to receive Regulatory Capital treatment for a period of 20 years from the effective date of the final rule.³

The final rule also contained a provision requiring Notes to have a minimum maturity of five years and a maximum maturity of 20 years.

¹ Throughout this document the Board uses the term “final rule” to refer to the final Subordinated Debt rule published in the *Federal Register* on February 23, 2021. The Board uses the term “the Current Rule” to refer to the current Subordinated Debt rule, as published in the Code of Federal Regulations, which includes the “final rule” and subsequent amendments.

² 86 FR 11060 (Feb. 23, 2021). Unless otherwise noted, capitalized terms in this preamble are defined in the Current Rule.

³ Id.

After the NCUA issued the final rule, Congress passed the Consolidated Appropriations Act, 2021.⁴ The Consolidated Appropriations Act, among other things, created the ECIP. Under the ECIP, Congress appropriated funds and directed Treasury to make investments in “eligible institutions” to support their efforts to “provide loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers, especially in low-income and underserved communities.”⁵ The definition of “eligible institutions” includes federally insured credit unions that are minority depository institutions or community development financial institutions, provided such credit unions are not in troubled condition or subject to any formal enforcement actions related to unsafe or unsound lending practices.⁶

Under the terms developed by Treasury, investments in eligible credit unions are in the form of subordinated debt.⁷ Treasury also aligned its investments in LICUs with the Federal Credit Union Act (the Act) and the NCUA’s regulations, which allowed eligible LICUs to apply to the NCUA for secondary capital treatment for these investments. Relevant to this proposed rule, Treasury offered either 15- or 30-year maturity options for the investments.

Treasury opened the ECIP application process on March 4, 2021, with an application deadline of May 7, 2021. Treasury extended this deadline to September 1, 2021.

⁴ Consolidated Appropriations Act, 2021, Pub. L. 116–260 (H.R. 133), Dec. 27, 2020.

⁵ *Id.* codified at 12 U.S.C. 4703a *et seq.*

⁶ 12 U.S.C. 4703a(a)(2). Throughout this document, the Board only refers to LICUs, as those are the only eligible institutions that could receive secondary capital treatment for the ECIP investments.

⁷ Throughout this document the term “Subordinated Debt” (initial caps) refers to issuances conducted under the Current Rule. Conversely, the term “subordinated debt” (lower-cased) refers to debt issuances conducted outside of the Current Rule, such as those under the ECIP.

In October 2021, the NCUA issued a Letter to Credit Unions permitting LICUs participating in the ECIP to issue 30-year subordinated debt instruments.⁸ This letter and its enclosure are discussed in more detail in subsequent sections of this document.

In December 2021, the Board issued a final amendment to the Current Rule permitting secondary capital to be considered GSC regardless of the actual issuance date, provided a secondary capital issuance was:

1. To the U.S. Government; and
2. Being conducted under a secondary capital application that was approved before January 1, 2022, under either § 701.34 of the NCUA's regulations for federal credit unions, or § 741.203 of the NCUA's regulations for federally insured, state-chartered credit unions.⁹

The final amendment and Letter to Credit Unions provided LICUs with additional flexibility to participate in the ECIP without being subject to the terms of the Current Rule.

B. Maturity and Regulatory Capital treatment for GSC

The Current Rule restricts the maturity of Notes to a minimum of five years and a maximum of 20 years. In alignment with this maximum maturity, the Current Rule also terminates Regulatory

⁸ Letter to Credit Unions 21-CU-11, Emergency Capital Investment Program Participation and enclosed Supervisory Letter No. 21-02 (Oct. 20, 2021), *available at* <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/emergency-capital-investment-program-participation>.

⁹ 12 CFR 701.34 and 741.203; 86 FR 72807 (Dec. 23, 2021).

Capital treatment for GSC after a period of 20 years beginning on the later of the date of issuance or January 1, 2022 (the effective date of the Current Rule).

As previously noted, under the ECIP, Treasury enabled LICUs to issue 30-year subordinated debt instruments. The Supervisory Letter enclosed to the Letter to Credit Unions discussed in section I of this document stated: “federally insured, state-chartered LICUs typically issue secondary capital under similar borrowing authority. As such, the agency has taken certain precautions to ensure that issuances under the ECIP that receive secondary capital treatment are considered debt. Such precautions have included the agency prohibiting LICUs from receiving secondary capital treatment for issuances under the ECIP’s 30-year option.”¹⁰ The Supervisory Letter, however, went on to state that after further consideration, the agency was recalibrating its position and permitting LICUs to issue 30-year subordinated debt under the ECIP. In relevant portion, the Supervisory Letter stated:

The agency has always recognized that no one term or factor of an ECIP instrument is dispositive in characterizing the nature of the instrument. As such, the agency is satisfied that the close collaboration between the NCUA and Treasury, the unique status of the ECIP, and the terms of the instrument have resulted in an instrument that complies with the Federal Credit Union Act, even with a 30-year term.¹¹

While this change facilitated LICU participation in the ECIP, the agency recognizes that there is a distinct mismatch between a 30-year ECIP subordinated debt instrument and the 20-year

¹⁰ Letter to Credit Unions 21-CU-11, Emergency Capital Investment Program Participation and enclosed Supervisory Letter No. 21-02 (Oct. 20, 2021).

¹¹ Id.

maximum Regulatory Capital treatment of the same. To address this discrepancy, the NCUA conducted additional research into the issues of maximum Regulatory Capital treatment for GSC and the broader issue of a maximum maturity for new Subordinated Debt issuances.

Both the maximum Regulatory Capital treatment for GSC and the maximum maturity for Notes are based on the statutory authority under which an FCU issues both instruments. Specifically, an FCU can only issue these instruments under its authority to borrow from any source. Therefore, the agency took precautions in the Current Rule to ensure that all issuances were in the form of debt. As noted in the January 2020 proposed Subordinated Debt rule, such precautions included imposing a maximum maturity of 20 years on Notes. The Board stated it was proposing such requirement “to help ensure the Subordinated Debt is properly characterized as debt rather than equity. Generally, by its nature, debt has a stated maturity, whereas equity does not.”¹²

With respect to GSC, the January 2020 proposed Subordinated Debt rule stated:

The Board believes 20 years would provide a LICU sufficient time to replace Grandfathered Secondary Capital with Subordinated Debt if such LICU seeks continued Regulatory Capital benefits of Subordinated Debt. The Board believes it is important to strike a balance between transitioning issuers of Grandfathered Secondary Capital to this proposed rule and ensuring that instruments do not indefinitely remain as Grandfathered Secondary Capital.¹³

¹² 85 FR 13892 (Mar. 10, 2020).

¹³ Id.

The 20-year Regulatory Capital treatment for GSC also aligned with the aforementioned maximum maturity for Notes issued under the Current Rule.

As the Board received feedback from the credit union industry on the mismatch between ECIP investment maturity and the Regulatory Capital treatment of the same, the NCUA conducted additional research into whether a 20-year maturity was necessary to ensure an FCU was operating squarely within its statutory authority when issuing Notes. While the Board continues to believe that a 20-year maturity is an appropriate demarcation point to ensure an FCU is issuing Subordinated Debt under its statutory authority, the agency's additional research has provided grounds to offer additional flexibility in this area. Based on this additional research, the Board is proposing the amendments discussed in the next section.

II. Proposed Changes

A. Regulatory Capital treatment for GSC

The Board is proposing revisions to § 702.401(b) to permit GSC to receive Regulatory Capital treatment for a period of 30 years from the later of the date of issuance or January 1, 2022. This change would accomplish multiple goals. First, it would align the Regulatory Capital treatment with the maximum permissible maturity for secondary capital issued under the ECIP. The Board believes that this change is necessary to enable LICUs to receive the maximum benefit of the ECIP, as intended by Congress and effectuated by Treasury. Capital with longer maturities helps credit unions make more loans to underserved communities and improve the economic well-being in these areas. In addition, longer maturities will also allow participating credit unions to meet the statutory mission of the credit union system of meeting the credit and savings needs of members, particularly those people of modest means

Second, this proposed change would align the Regulatory Capital treatment across all GSC. This alignment provides additional flexibility to those LICUs with GSC that has a maturity longer than 20 years, while still striking a balance between transitioning issuers of GSC to the Current Rule and ensuring that instruments do not indefinitely remain as GSC. Further, as discussed in the next subsection, this alignment would also be consistent with the Board's proposed recalibration of the maturity requirement for Notes issued under the Current Rule.

B. Maximum maturity of Notes

As noted earlier, the Current Rule contains the following requirement that Notes:

Have, at the time of issuance, a fixed stated maturity of at least five years and not more than 20 years from issuance. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity[.]¹⁴

Additionally, the Board implemented this requirement to help an FCU issuing Subordinated Debt comply with its statutory authority.¹⁵ As industry experts have correctly pointed out, the fixed stated maturity of an instrument is but one factor a court will evaluate in deciding whether an instrument is debt or equity. Courts have traditionally listed between 9 and 13 factors to be evaluated in determining if an instrument is debt or equity.¹⁶

¹⁴ *Id.* at 702.404(a)(2).

¹⁵ While the Current Rule applies to both FCUs and FISCUs, authority for issuances by FISCUs is derived from state law, rather than the Act.

¹⁶ *Hewlett-Packard Co. v. Comm'r*, 103 T.C.M. (CCH) 1736 (T.C. 2012), *aff'd sub nom. Hewlett-Packard Co. v. Comm'r*, 875 F.3d 494 (9th Cir. 2017). *A.R. Lantz Co.*, 424 F.2d at 1333 (citing *O.H. Kruse Grain & Milling v. Comm'r*, 279 F.2d 123, 125–126 (9th Cir. 1960), *aff'd* T.C. Memo.1959–110).

During the formulation of the Current Rule, the agency engaged the services of an outside law firm that specializes in, among other things, taxation and securities law. Based on the research conducted by that firm and NCUA staff, the Board determined that 20 years was an advantageous demarcation point. NCUA staff and the Board are aware that courts have never set a strict limit on the length of a fixed stated maturity for purposes of a debt versus equity analysis. The agency recognizes that courts have, in some cases, found an instrument to be debt despite a maturity in excess of 50 years.¹⁷ As discussed by legal scholars, as a general rule, the shorter the time between issuance of the debt instrument and the maturity or redemption date, the more the instrument appears to be debt.¹⁸ Therefore, the Board continues to believe that 20 years is a sufficient demarcation point to balance flexibility with a rule firmly rooted in statutory authority. The Board, however, recognizes that a fixed stated maturity date is but one factor in a debt versus equity analysis, and, as noted by the U.S. Supreme Court: “[t]here is no one characteristic . . . which can be said to be decisive in the determination of whether obligations are risk investments in the corporations or debt.”¹⁹ Considering the factors mentioned above, the Board is proposing to provide Issuing Credit Unions with additional flexibility on this requirement.

The Board is proposing to remove the maximum maturity limit of 20 years from § 702.404(a)(2) of the NCUA regulations.²⁰ In its place, the Board is proposing a requirement that a credit union must provide certain information in its application for preapproval under § 702.408 when

¹⁷ “Although 50 years might under some circumstances be considered as a long time for the principal of a debt to be outstanding, we must take into consideration the substantial nature of the * * * [taxpayer's] business, and the fact that it had been in corporate existence since [*62] 1897, or 61 years prior to the issuance of the debentures. Therefore, we think that a 50–year term in the present case is not unreasonable. * * * [*Monon R.R. v. Comm’r*, 55 T.C. at 359]. *PepsiCo Puerto Rico, Inc. v. Comm’r*, 104 T.C.M. (CCH) 322 (T.C. 2012).”

¹⁸ “Federal Income Taxation of Debt Instruments,” David C. Garlock, Matthew S. Blum, Kyle H. Klein, Richard G. Larkins & Alan B. Munro (2011).

¹⁹ *John Kelley Co. v. Comm’r*, 326 U.S. 521, 530 (1946).

²⁰ 12 CFR 702.404(a)(2).

applying to issue Notes with maturities longer than 20 years from the date of issuance. To demonstrate the issuance is debt, this proposal includes a new paragraph in § 702.408(b) that requires a credit union applying to issue Notes with maturities longer than 20 years to submit, at the discretion of the Appropriate Supervision Office, one or more of the following:

1. A written legal opinion from a Qualified Counsel;
2. A written opinion from a licensed CPA; and
3. An analysis conducted by the credit union or independent third-party.

The Board believes this proposed structure would provide a credit union with additional flexibility to issue Notes with maturities longer than 20 years, provided the credit union can demonstrate that the Notes would be considered debt. The Board notes that the discretion on what information is necessary to satisfy this requirement would rest with the Appropriate Supervision Office, but this determination would be based on the overall structure of the issuance, including the fixed stated maturity and any other information requested by the Appropriate Supervision Office.²¹

As the entire Current Rule is designed to help ensure Notes would be considered debt, the Board does not anticipate that a legal or CPA opinion would be necessary for issuances that have fixed stated maturities that are not significantly longer than 20 years and do not contain any other features or terms that could be viewed as akin to an equity issuance. The Board notes, however, that every issuance is unique and, while unlikely, it is still possible a legal or CPA opinion may

²¹ Id. at § 702.408(b).

be necessary to fully ensure that a Note would be considered debt irrespective of the degree to which the maturity exceeds 20 years.

The Board believes this proposed structure is consistent with its original line of thinking with respect to debt versus equity and fixed stated maturities. However, this proposed structure more fully takes account of the other debt features of the Current Rule and the court decisions on debt versus equity.

C. Other Proposed Changes

1. Qualified Counsel

The Board is proposing to amend the definition of “Qualified Counsel” to clarify where such person(s) must be licensed to practice law. Current § 702.402 defines “Qualified Counsel” as “an attorney licensed to practice law in the relevant jurisdiction(s) who has expertise in the areas of Federal and state securities laws and debt transactions similar to those described in this subpart.”²² The agency is aware that there is some confusion about the requirement that such person be “licensed to practice law in the relevant jurisdiction(s).” The Board’s intention is not to mandate that “Qualified Counsel” be licensed to practice law in every jurisdiction that may be relevant to the issuance. Rather, this requirement is meant to specify that a “Qualified Counsel” is:

1. Licensed to practice law;

²² Id. at § 702.402.

2. Has expertise in the areas of Federal and state securities laws and debt transactions similar to those described in the Current Rule; and

3. Qualified to provide sufficient advice to a credit union to comply with the requirement in § 702.406(f) that an Issuing Credit Union must comply with all applicable Federal and state securities laws.²³

Therefore, the Board is proposing to remove “in the relevant jurisdiction(s)” from the definition of “Qualified Counsel.” This change would clarify the intention of this requirement and lessen the burden on credit unions, while not detracting from the expertise aspect of this requirement. The Board, however, reiterates that under § 702.406(f), an Issuing Credit union must comply with all Federal and state securities laws. An Issuing Credit Union, therefore, must ensure that it is able to ascertain, understand, and comply with all securities laws that apply to an issuance.

2. Statement of Cash Flows

The Board is proposing to amend §§ 702.408(b)(7) and 702.409(b)(2) to remove the statement of cash flow from the Pro Forma Financial Statements requirement and replace it with the requirement for cash flow projections.²⁴ Since the final rule was published in early 2021, NCUA has received several inquiries on the requirement of a pro forma statement of cash flow and whether a cash flow projection will suffice. The primary difference between a pro forma statement of cash flow and a cash flow projection is the former is a formal accounting statement and the latter is not. The Board believes a cash flow projection would suffice because the Appropriate Supervision Office needs cash flow projections, but not necessarily a Generally

²³ *Id.* at § 702.406(f).

²⁴ *Id.* at §§ 702.408(b)(7) and 702.409(b)(2).

Accepted Accounting Principles accounting statement to evaluate the viability of an issuance.

This change would also increase clarity in the Current Rule.

3. Filing requirements and inspection of documents

The Board is proposing to amend the section of the Current Rule addressing the filing of documents and inspection of documents.²⁵ First, the Board is proposing to amend the title of this paragraph by removing the phrase “inspection of documents.” This phrase could be confusing, as this paragraph does not include a separate mechanism for inspecting documents outside of the Freedom of Information Act. As most Subordinated Debt documents submitted to the agency could be exempt from disclosure, the Board believes the Freedom of Information Act is the appropriate mechanism for requesting Subordinated Debt applications, Offering Documents, or other Subordinated Debt filings submitted by credit unions from the NCUA.

Second, the Board is proposing to replace the current requirement that a credit union submit all applicable documents via the NCUA’s website with a requirement that a credit union make all submissions directly to the Appropriate Supervision Office. The Board notes that this proposed change is consistent with current practices, as well as how filings were handled for secondary capital. As most credit unions are already accustomed to this process, the Board believes this change would reduce confusion and forgo an additional step in the submission process.

4. Categorization of GSC that no longer counts as Regulatory Capital

The Board is proposing to revise § 702.414(c) by removing “(“discounted secondary capital” re-categorized as Subordinated Debt).” This change would align this section to the current treatment

²⁵ *Id.* at § 702.408(l)(2).

of GSC on the Call Report, revised in the spring of 2022. In early 2022, the NCUA conducted a comprehensive review of the Call Report that led to the removal of the “Subordinated Debt” and “Subordinated Debt included in Net Worth” accounts and combined them into one “Subordinated Debt” line. This change makes the aforementioned parenthetical obsolete. The Board notes, however, that while the Call Report has changes related to the reporting of Subordinated Debt in the Liability section, credit unions will continue to count qualified and approved Subordinated Debt or GSC for Net Worth and Risk-Based Capital, when applicable.

III. Regulatory Procedures

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA) applies to rulemaking in which an agency creates a new or amends existing information collection requirements.²⁶ For purposes of the PRA, an information collection requirement may take the form of a reporting, recordkeeping, or a third-party disclosure requirement. The NCUA may not conduct or sponsor, and the respondent is not required to respond to an information collection, unless it displays a valid Office of Management and Budget (OMB) control number. The current information collection requirements for Subordinated Debt are approved under OMB control number 3133–0207.

This rule proposes to remove the maximum maturity of Subordinated Debt Notes of 20 years and replace it with a requirement that a credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years, provide additional information as part of its application prescribed under new § 702.408(b)(15). This proposed reporting requirement is estimated to impact two credit unions applying to issue Subordinated Debt for an additional 20 hours per

²⁶ 44 U.S.C. 3507(d); 5 CFR part 1320.

response, an increase of 40 burden hours annually. The following shows the total PRA estimate for the entire Subordinated Debt rule, inclusive of the additions referenced in the preceding sentence:

OMB Control Number: 3133–0207.

Title of information collection: Subordinated Debt, 12 CFR Part 702, Subpart D.

Estimated number respondents: 3,300.

Estimated number of responses per respondent: 1.12.

Estimated total annual responses: 3,705.

Estimated total annual burden hours per response: 1.54.

Estimated total annual burden hours: 5,702.

The NCUA invites comments on: (1) whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; (4) ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; and (5) estimates of capital or start-up costs and cost of operation, maintenance, and purchase of services to provide information.

All comments are a matter of public record. Interested persons are invited to submit written comments to (1) www.reginfo.gov/public/do/PRAMain (find this particular information collection by selecting the Agency under “Currently under Review”) and to (2) Dawn Wolfgang, National Credit Union Administration, 1775 Duke Street, Suite 6032, Alexandria, VA 22314-3428; Fax No. 703-519-8579; or email at PRAComments@ncua.gov. Given the limited in-house staff because of the COVID-19 pandemic, email comments are preferred.

B. Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. The NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the Executive Order to adhere to fundamental federalism principles.

This proposed rule would not have substantial direct effects on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The proposed rule would affect only a small number of state-chartered LICUs with approved secondary capital applications for issuances to the U.S. Government or its subdivisions. This proposed rule would extend the Regulatory Capital treatment for GSC, eliminate the maximum maturity for Subordinated Debt, and make two minor clarifying changes. The proposed rule would not impose any new significant burden on credit unions and may ease some existing requirements. The NCUA has therefore determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

C. Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

D. Regulatory Flexibility Act

The Regulatory Flexibility Act²⁷ requires the NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small entities (defined as credit unions with under \$100 million in assets).²⁸ This proposed rule would affect only a small number of LICUs with approved secondary capital applications for issuances to the U.S. Government or its subdivisions. This proposed rule would extend the Regulatory Capital treatment for GSC, eliminate the maximum maturity for Subordinated Debt, and make two minor clarifying changes. The proposed rule would not impose any new significant burden on credit unions and may ease some existing requirements. Accordingly, the NCUA certifies that this proposed rule would not have a significant economic impact on a substantial number of small credit unions.

List of Subjects

12 CFR Part 702

Credit unions, Reporting and recordkeeping requirements.

By the NCUA Board on September 22, 2022.

²⁷ 5 U.S.C. 601 *et seq.*

²⁸ *Id.* at 603(a); NCUA Interpretive Ruling and Policy Statement 15-2.

Melane Conyers-Ausbrooks,
Secretary of the Board.

For the reasons discussed in the preamble, the NCUA Board proposes to amend 12 CFR part 702, as follows:

PART 702—CAPITAL ADEQUACY

1. The authority citation for part 702 continues to read as follows:

Authority: 12 U.S.C. 1766(a), 1790d.

2. Revise § 702.401(b) to read as follows:

§ 702.401 Purpose and scope.

* * * * *

(b) *Grandfathered Secondary Capital.* Any secondary capital defined as “Grandfathered Secondary Capital,” under § 702.402 of this part, is governed by § 702.414 of this part. Grandfathered Secondary Capital will no longer be treated as Regulatory Capital as of the later of 30 years from the date of issuance or January 1, 2052.

3. In § 702.402, revise the definitions for “Qualified Counsel” and “Regulatory Capital” to read as follows:

§ 702.402 Definitions.

* * * * *

Qualified Counsel means an attorney licensed to practice law who has expertise in the areas of Federal and state securities laws and debt transactions similar to those described in this subpart.

Regulatory Capital means:

(1) With respect to an Issuing Credit Union that is a LICU and not a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in the credit union's net worth ratio;

(2) With respect to an Issuing Credit Union that is a complex credit union and not a LICU, the aggregate outstanding principal amount of Subordinated Debt that is included in the credit union's RBC Ratio, if applicable;

(3) With respect to an Issuing Credit Union that is both a LICU and a complex credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is included in its net worth ratio and in its RBC Ratio, if applicable; and

(4) With respect to a new credit union, the aggregate outstanding principal amount of Subordinated Debt and, until the later of 30 years from the date of issuance or January 1, 2052, Grandfathered Secondary Capital that is considered pursuant to § 702.207.

* * * * *

4. In § 702.404, revise the section heading and paragraph (a)(2) to read as follows:

§ 702.404 Requirements of the Subordinated Debt Note.

(a) * * *

(1) * * *

(2) Have, at the time of issuance, a fixed stated maturity of at least five years. The stated maturity of the Subordinated Debt Note may not reset and may not contain an option to extend the maturity. A credit union seeking to issue Subordinated Debt Notes with maturities longer than 20 years from the date of issuance must provide the information required in § 702.408(b)(14) as part of its application for preapproval to issue Subordinated Debt;

* * * * *

5. In § 702.408:

a. Revise paragraph (b)(7);

b. Redesignate paragraphs (b)(14) and (15) as paragraphs (b)(15) and (16);

c. Add new paragraph (b)(14); and

d. Revise paragraph (l)(1).

The revisions and addition read as follows:

§ 702.408 Preapproval to Issue Subordinated Debt.

* * * * *

(b) * * *

* * * * *

(7) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios;

* * * * *

(14) In the case of a credit union applying to issue Subordinated Debt Notes with maturities longer than 20 years, an analysis demonstrating that the proposed Subordinated Debt Notes would be properly characterized as debt in accordance with U.S. GAAP. The Appropriate Supervision Office may require that such analysis include one or more of the following:

(i) A written legal opinion from a Qualified Counsel;

(ii) A written opinion from a licensed CPA; and

(iii) An analysis conducted by the credit union or independent third party;

* * * * *

(1) ***Filing requirements.***

(1) Except as otherwise provided in this section, all initial applications, Offering Documents, amendments, notices, or other documents must be filed electronically with the Appropriate Supervision Office. Documents may be signed electronically using the signature provision in 17 CFR 230.402 (Rule 402 under the Securities Act of 1933, as amended).

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6. In § 702.409, revise paragraph (b)(2) to read as follows:

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(b) * * *

(2) Pro Forma Financial Statements (balance sheet and income statement) and cash flow projections, including any off-balance sheet items, covering at least two years. Analytical support for key assumptions and key assumption changes must be included in the application. Key assumptions include, but are not limited to, interest rate, liquidity, and credit loss scenarios.

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§ 702.414 [Amended]

7. In § 702.414(c) introductory text, remove the phrase “(“discounted secondary capital” re-categorized as Subordinated Debt)”.

